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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 38

HOWARD S. PALMER, JAMES LEE LOOMIS and HENRY B. SAWYER, Trustees of the Property of The New York, New Haven and Hartford Railroad Company, Debtor,

Petitioners,

AGAINST

CONNECTICUT RAILWAY AND LIGHTING COMPANY,

Respondent.

BRIEF FOR RESPONDENT.

Opinion Below.

The opinion of the Court of Appeals (2nd Circuit) (Patterson, *J.*) is reported in 109 Fed. (2nd) 568.

Jurisdiction.

Jurisdiction to issue the writ is vested in this Court by Sec. 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938.

Question Presented.

In calculating the landlord's damages for rejection of a lease, under the rule laid down by the Supreme Court in this case (305, U. S. 493, 504), "the present value of the rent reserved less the present rental value of the remainder of the term", is it required that the landlord prove that the sum of the annual rental values of the leased property in each year of the remainder of the term is less than the sum of the annual rentals under the lease for that period?[1]

The Respondent contends that the answer is: No; the object is to find the present value of the rejected lease, and that object is achieved when sufficient past and present data are produced to enable an ordinary prudent person to come to an informed and reasoned judgment with regard to the present value. Extrapolation into the future will be limited by common sense.

Statement.

Respondent was landlord, and the New Haven Railroad was tenant, under a 999-year lease of trolley properties. The New Haven went into bankruptcy, under Sec. 77 of the Bankruptcy Act; and its Trustees rejected the lease, which then had 969 years still to run.

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[1] The Petitioner also presents the question of the sufficiency of the evidence to support the damages allowed below, and remarks that: "It is not apparent how the sum of $4,411,837.61 was arrived at by the Circuit Court of Appeals" (Petitioner's Brief, p. 25). The explanation of the computation, and the reference to the evidence on which it is based are set forth in Appendix A, at page 12, *Infra*.

Respondent filed a claim for damages arising from the rejection of its lease, and was allowed $1,263,412.92 as damages for the period from rejection (December 18, 1935) to hearing on the claim (June 30, 1937). For any period after final hearing the District Court allowed nothing, saying the statute ["the actual damage or injury determined in accordance with principles obtaining in equity proceedings"] meant that only damages accrued without acceleration at the date of hearing could be proved.

This disposition was affirmed by the Circuit Court of Appeals (95 Fed. (2nd) 483).

It was reversed by the Supreme Court (305 U. S. 493), which held that if claims for rent to accrue under a lease are to be discharged then they must be made provable, for they cannot be simply destroyed (299 U. S. 439). The case was then remanded to the District Court for further proceedings in accordance with the opinion.

At the hearing (March 13, 1939) all the witnesses were called by Respondent. The New Haven called none. There was no conflicting testimony. There was no question involving the credibility of witnesses. The evidence was essentially reduced to written exhibits, now found in the record (R. 220-263). The basic figures for the period 1907-1937 were supplied by the New Haven Railroad, which had operated the properties during that period, and from November 16, 1937 (date of surrender of the properties to the landlord) to December 31, 1938, were taken from the actual operating records of Respondent. The problem was to find the rental value of the landlord's property—the difference between the rent and the rental value being the damages.

The District Court held: that the operating history of the property showing the operating revenues back to 1907 (R. 271) was inadequate, as an experience period for estimating future earnings, to support "an assessment for the unexpired term of 969 years, which is the only term with which we are here concerned" (R. 277). "When the Supreme Court emphasized the high standard of proof required and the inherent difficulty of complying therewith, it contemplated that non-compliance should result in disallowance, not in a modification of standard and measure" (R. 278). "There is no basis for the assumption implicit in claimant's position that a past experience of even thirty years of earnings has a forecasting value for a period of over 900 years" (R. 279).

And so the whole claim for damages for rejection of the lease was disallowed—even the $1,263,412.92 allowed on the former trial was revoked (R. 287).

Respondent appealed to the Court of Appeals, which reversed (109 Fed. (2nd) 568), holding it was error to rule that the inability of Respondent to prove rental value over the entire 969 years sufficed to defeat the claim (*supra*, p. 571).

The opinion of the Court of Appeals succinctly sets forth what the Court did. In order to find a "normal" year, and thus a "normal" operating income which would indicate a true rental value,[2] an experience period of 14 years

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[2] Presumably this Court will not review the evidence or inferences drawn from it. *General Talking Pictures Co.* v. *Western Electric Co.*, 304 U. S. 175, 178. Accordingly, the mechanics of the calculation of the rental value have been relegated to Appendix B, at page 14, *Infra*.

was selected, for reasons which are stated. The rental value being thus ascertained (R. 240), the computations of damages based on annual rental values for all future periods up to forty years were already worked out in the exhibits (R. 236-239). The selection of the experience period and the length of the forecast were judicial operations, and the only ones required; the exhibits at once gave the result in dollars. The credibility of no witness was involved; no conflict of evidence required to be resolved; in the circumstances the Court of Appeals wrote the answer itself, instead of sending the case back to the District Court for a third trial.

Argument.

The formula laid down by the Supreme Court for calculating the amount of the landlord's claim for the loss of his lease is that the damages are "the difference between the rental value of the remainder of the term and the rent reserved, both discounted to present worth."

City Bank Co. v. *Irving Trust Co.*, 299 U. S. 433, 443.
Kuehner v. *Irving Trust Co.*, 299 U. S. 445, 450.
Connecticut Ry. Co. v. *Palmer*, 305 U. S. 493, 504.

The Court has stated this rule of damages as though it were a mathematical formula for ascertaining an answer in dollars but of course, in addition, it is a recognized method of ascertaining the value to the landlord of the lost lease at the time of its rejection. Because, what the landlord loses is his lease, and the damages are merely the net value of the lease.

The District Court considered that the formula was a mathematical prescription, which must be worked out from rent day to rent day all through the balance of the term of a lease in order to make sure that in no rent period, or in no series of rent periods, sufficient net avails should be realized from the property to recoup or even to exceed the amount of the lost rentals. The factor which causes the difficulty in the application of the formula in such a way is not the amount of the reserved rent and its present value discounted, but the amount of the rental value presumably based on the future net operating income from the property. In a situation like this, where the lease has no market value whatever, the formula for ascertaining the value of the lease must be applied; but it must be applied in such a way that "the damage will be based on evidence which satisfies the mind" (305 U. S. 505).

What this means is that when the evidence as to future rental value of the property attempts to cover so long a span of time into the future that, to the mind of the ordinary man, no conviction is carried that the conclusion which is going to be reached is not just pure speculation, then a point is arrived at where "reasonable certainty" disappears and prospective losses beyond that point can no longer be recovered. All this is merely the application of "the usual rules as to the measure of damages."

Williston on Contracts, (Rev. Ed.) §1346.
Hetzel v. *B. & O. R. Co.,* 169 U. S. 26, 28.

Obviously; it was not the intention of the Supreme Court, in *Connecticut Railway Co.* v. *Palmer,* 305 U. S. 493, to lay down a novel rule of damages: an-all-or-nothing rule which

required that each unit of time over the remainder of a term of 900 years should be accounted for as a period of a loss to the landlord. It was evident on the previous appeal to the Supreme Court that this Court considered the far future as unpredictable; for one of the Justices inquired of counsel for the Respondent, on the hearing, whether he claimed to have evidence which would show the rental value of the demised property 500 years in the future. To this counsel for the Respondent replied that he had no such evidence, and that he considered it was physically impossible to produce such evidence. This conclusion also is the one which is arrived at by the Court of Appeals:

> "It goes without saying that damages for 969 years cannot be imagined, much less proved. The remainder of the lease covers a span longer than from the battle of Hastings to the present day. To try to forecast events for even a tenth of that futurity would appall the boldest prophet" (R. 297).

If the Supreme Court had intended to lay down an-all-or-nothing rule, they would have dismissed the previous appeal (305 U. S. 493). For on that appeal Connecticut Railway and Lighting Company was the Appellant; and it came to the Court complaining that it had been awarded $1,263,412.92 damages for the loss of its lease accrued to the date of hearing before the District Court, but had not been allowed to prove damages on account of rentals under the lease accruing for any period subsequent to the date of the hearing before the District Court. If it had been the intention of the Supreme Court to have prescribed an-all-or-nothing rule patently impossible to comply with

in this case, they would have dismissed the appeal of Connecticut Railway and Lighting Company, saying that the landlord had already received from the District Court more than the formula for computing the damages would permit the landlord to receive.

When the Supreme Court reversed on the last appeal, it did not reverse on the ground that the Appellant had received too much, but too little; and, when the claim was sent back for a new trial before the District Court, the opinion of the Supreme Court was to be construed, not as laying down a novel rule of damages, but as a caution against an award of damages on anything like a 969 year basis. The reason is plain: no ordinary prudent man could possibly estimate the value of the lost lease as of the time of rejection on any such basis; but this does not mean that the lease has not a present value, nor that that value cannot be ascertained by the application of the formula to data which are reasonably certain, so far as any one can see, to be true and applicable; and the Court of Appeals, applying this common-sense interpretation of the Supreme Court's opinion, came to the conclusion that reasonable certainty was attained by allowing the Respondent damages for eleven years subsequent to rejection of the lease, *i. e.* three years prior to the trial in the District Court for which the damages are fully known, and eight years for which damages are estimated according to past experience for 14 years (R. 300).

This was the net value of the lease at the time it was destroyed by rejection. It is not the result of the application of a precise mathematical formula for a limited number of years, and the ignoring of a subsequent vast period

of time. It is a conclusion that the subsequent vast period of time is not an element which can enter into the present net value of the lease. This subsequent time has been weighed and found to be incommensurable with reasonable certainty.

On this question the Restatement is clear.

A. L. I. Restatement of Contracts, §331(a):

> "The requirement of reasonable certainty [the words of the Supreme Court, 305 U. S. 505] does not mean that the plaintiff can recover nothing unless he establishes the total amount of his harm; nor does it mean that he cannot get damages unless he proves the exact amount of his harm. The requirement merely excludes those elements of harm that cannot be evaluated with a reasonable degree of certainty."

The rule set forth in the Restatement is amply supported by authority.

Hedrick v. *Perry*, 102 Fed. (2) 802.

The Court (Tenth Circuit) says at page 807:

> "The tendency of the early cases was to restrict the recovery of damages to matters which were susceptible of having attributed to them an exact pecuniary value. But that rigid rule has been relaxed in some measure. Recovery cannot be had where there is uncertainty whether a contract has been breached or a tort committed, but damages may be awarded where there is no uncertainty as to whether the rights of plaintiff have been invaded even though there may be some uncertainty in respect to the amount of the damages sustained. The amount need not be proved with absolute certainty. It is enough if the evidence adduced is sufficient to enable the court or jury to make a fair and reasonable approximation. Story Parchment Co. v. Paterson Parchment Paper Co., 282 U. S. 555, 51 S. Ct. 248,

75 L. Ed. 544; Hoffer Oil Corporation v. Carpenter, 10 Cir., 34 F. 2d 589; Shannon v. Shaffer Oil & Refining Co., 10 Cir., 51 F. 2d 878; Stanolind Oil & Gas Co. v. Kimmel, 10 Cir., 68 F. 2d 520; Indian Territory Illuminating Oil Co. v. Townley, 10 Cir., 81 F. 2d 159; Excelsior Motor Manufacturing & Supply Co. v. Sound Equipment Co., 7 Cir., 73 F. 2d 725; Commonwealth Trust Co. v. Hachmeister Lind Co., 320 Pa. 233, 181 A. 787."

See also:

Sheldon v. *Metro-Goldwyn Pictures Corp.*, 106 Fed. (2) 45, 51; affirmed, 309 U. S. 390.

Eastman Kodak Co. v. *Southern Photo Materials Co.*, 273 U. S. 359;

Sinclair Refining Co. v. *Jenkins Petroleum Process Co.*, 289 U. S. 689, 697;

Pieczonka v. *Pullman Co.*, 102 Fed. (2) 432, 434.

As to the evidence, the Court of Appeals says:

"It follows that the district judge should have allowed at least the damages accrued prior to trial [$1,828,971.02]. To that extent there was no element of speculation or uncertainty. See *Greenberg* v. *Paramount Publix Corporation*, 85 F. (2d) 42, 45 (C. C. A. 2). As to damages to accrue in the future, we think that the judge was unduly critical of the evidence offered by the claimant. The claimant showed what the past earnings of the system had been, and evidence of past earnings in an established business is recognized as a substantial basis for estimating future earnings. *Anvil Mining Co.* v. *Humble*, 153 U. S. 540; *Eastman Kodak Co.* v *Southern Photo Materials Co, supra; Story Parchment Co.* v. *Paterson Parchment Paper Co.*, 282 U. S. 555; Williston on Contracts (Rev. Ed.), section 1346A." (R. 298.)

Conclusion.

The Court of Appeals was right in eliminating imponderable factors from the calculation of the value of the lost lease. It was not the intention of the Supreme Court to require proof of value beyond the bounds of foresight, under pain of denying any recovery. On the contrary, this Court issued a caution against an award of damages based on anything like a 969 year basis.

The directions of the Supreme Court have been completely followed, the prescribed requirements have been met, and the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

George W. Martin,
Counsel for Respondent.

October 17, 1940.

APPENDIX A.

Judge Patterson says in his Opinion (R. 300; 109 Fed. (2d) 572):

> "In the present case the evidence suffices for exercise of an informed and reasoned judgment on the probable earnings in the future. Having in mind the character of the property, the territory served, the history of operations down to the time of the trial, the general economic conditions under which past operations have been conducted, and the other factors in the case, we conclude that performance of the property for eight years beyond 1938 was predictable with a fair degree of certainty. This will allow the claimant damages for eleven years subsequent to rejection of the lease, the three years prior to trial for which damages are known and eight more years for which damages are estimated according to past experience for 14 years. The difference between agreed rent and rental value on this basis, discounted to present worth at the time of rejection, amounts to $4,411,837.61. The claim for damages on rejection of lease should have been allowed in that amount."

This means the damages were calculated according to Exhibit X-2D (R. 236), which is the Exhibit recording the experience period for 14 years. The agreed rent for the 11-year period used amounted to $9,194,676.59 (Line 11 of Column 4 of Exhibit X-2D). Columns 5 and 6 of that Exhibit give the rental value: Column 5 by years, and Column 6 accumulative. In calculating Columns 5 and 6, the sum of $589,551. was used as an annual rental value for the years 1939-75 inclusive (See notes to Exhibit X-2D, R. 239). The statement on page 238 of the Record explains the use of the three factors which make up the rental value under the Opinion of the Supreme Court: the sinking fund in-

come, the net operating income and the sinking fund payments. It was conceded in the Landlord's Brief before the Court of Appeals that Columns 5 and 6 should have been calculated, using the sum of $618,004.61 as the rental values for the years 1939-75 inclusive, instead of $589,551. The reason for this was that the figures supplied by the New Haven Railroad were repudiated by them after the Exhibit was made up and other figures were substituted which made the change necessary (Ex. Y-1, R. 256).

If Columns 5 and 6 are re-calculated, accordingly, it will be found that Line 11 of Column 6 of Exhibit X-2D should be $4,782,838.98. If this figure is then subtracted from $9,194,676.59 listed above, the difference is $4,411,837.61, which amount is the damages calculated by Judge Paterson. If the first eleven lines of Columns 5 and 6 were recalculated using the figure $618,004.61 as the rental value for the years 1939-46, these columns would read as follows:

		Col. (5)	*Col. (6)*
1	1936	$435,372.50	$ 435,372.50
2	1937	356,645.33	792,017.83
3	1938	291,825.40	1,083,843.23
4	1939	528,272.93	1,612,116.16
5	1940	507,954.74	2,120,070.90
6	1941	488,418.02	2,608,488.92
7	1942	469,632.71	3,078,121.63
8	1943	451,569.92	3,529,691.55
9	1944	434,201.84	3,963,893.39
10	1945	417,501.77	4,381,395.16
11	1946	401,444.01	4,782,838.98

Col. (4)	$9,194,676.59
Less Col. (6)	4,782,838.98
	$4,411,837.61 revised damages.

APPENDIX B.

Calculation of the Rental Value.

The rental value is the factor which is subtracted from the rent in order to find the landlord's damages. Under the opinion of the Supreme Court, the factor of rental value is composed of *two items besides the net earnings.* In affirming the dismissal of the New Haven's counterclaims, the Court said:

> "The betterments and sinking funds having come into the possession of the lessors by the terms of the lease are not to be considered as offsets against the claim of the lessor. Their possession by the lessor increases the earning power of the assets to the benefit of the lessee," (305 U. S. 505).

Obviously the "betterments" automatically swell the net earnings without further adjustment. Three-quarters of the sinking fund, as of the date of the rejection of the lease, had been built up by annual amortization instalments paid into it by the New Haven pursuant to the terms of the lease.

I.

Interest from Sinking Fund.

Three-quarters of the C. R. & L. sinking fund to secure its outstanding 4½% bonds amounted, at petition filed, to $125,755.96 in cash, and $3,369,750. in C. R. & L. bonds. Applying the cash to the purchase of additional bonds results in three-quarters of the sinking fund, on January

1, 1936, containing $3,489,518. in bonds. The annual interest on these bonds would be $157,028.13 (Ex. X-5; R. 76, 244).

The bonds in the sinking fund, therefore, produced, as interest, $157,028.13; and the money to purchase these bonds was contributed by the New Haven, pursuant to the lease (R. 22), and so "the earning power of the assets" is thus increased by that much annually. This amount, therefore, is credited to the New Haven by adding to it the annual rental value of the property. The amount cannot change for the lease has been terminated by rejection; and the New Haven will never, after petition filed, again contribute anything further to the sinking fund (R. 158). To the extent that capital contributions were made before that time, the increased earning power of the fund benefits the lessee in the same way that betterments in the physical property do. If additions to the fund should be hereafter made by others that is no reason for awarding further benefit to the New Haven.

So, this item of rental value is fixed at $157,028.13 annually (R. 273).

II.

Payments to Sinking Fund.

The sinking fund was built up by annual instalments contributed by the New Haven. The New Haven, having rejected the lease, has lost the right to recoup these payments by the refunding operation which it agreed to perform in 1951 (R. 23), and the fund now belongs to claimant. All courts agree as to this.

Nevertheless the stipulated rent was fixed at an amount to provide for these amortization payments, three-quarters of which amounted to $49,713.75 annually (Ex. X-1; R. 66, 220); and it does not seem fair to require the New Haven to continue payments into a sinking fund which it has lost the right to recapture. And so, in all the calculations involving rental value submitted by claimant this item, too, has been added and credited to the New Haven. When the possibility of any reduction in the rent by reason of refunding by the New Haven became extinct, the liability to contribute further to the sinking fund should likewise become extinct, and the parties' reciprocal liabilities should be calculated accordingly.

So, this item of rental value is fixed at $49,713.75 annually (R. 272).

III.

Operating Income.

The third constituent composing rental value is the net operating income from the demised properties. The actual operating figures are available only for the years 1936, 1937 and 1938 (and thirteen days in 1935). The reason for this is that, previous to the rejection of the lease on December 18, 1935, the claimant's properties were operated by The Connecticut Company (the New Haven's subsidiary) as an undivided component of the entire properties operated. After the rejection of the lease, the Court directed that separate accounts be kept covering the claimant's properties and those owned by The Connecticut Company; and this was done (R. 268). The separate fig-

ures, therefore, are available for the three years mentioned; 1936 reflecting operation by The Connecticut Company—until November 16, 1936 (when the properties were surrendered to claimant), and 1937 and 1938 reflecting operation by claimant. These three years, accordingly, furnish net operating income figures based on actual past fact, and involve no *nunc pro tunc* allocations or apportionments.

This is the reason why all the series of X-2 Exhibits have the same figures in the first three lines of Columns (5), (6), (7), and (8). These figures are derived from three constants and one variable—all based on past facts; the rent reserved (a constant), from which is subtracted the bond interest, $157,028.13 (a constant), *and* the amortization instalment, $49,713.75 (a constant), *and* the actual operating income for each of the three years respectively (a variable) as shown in the Statement attached to each of the X-2 Exhibits. The whole has been discounted back to January 1, 1936, at 4%.[3]

It is not till the fourth line of the Columns that forecasting is necessary, and then only in connection with the one factor which is a variable. That one factor has got to be made a constant if it is to be used in a mathematical series. When it is reduced to a constant by the application of an

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[3] This date is 13 days after rejection of the lease. It is taken because it enables the use of calendar years in making the calculations. The rate of discount, 4%, is the reasonable value of money (Ex. X-8, X-9, X-10; R. 246-252, 270). *Briscoe* v. *United States*, 65 Fed. (2) 404; *S. S. Black Gull*, 90 Fed. (2) 619; *C. & O. Ry. Co.* v. *Kelly*, 241 U. S. 485 (R. 74).

average, it will not be mathematically accurate. It cannot be. It need not be.

1 *Sutherland on Damages* (4th Ed.), § 121;
Schell v. *Plumb*, 55 N. Y. 592, 598;
Rugg v. *Rohrbach*, 110 Ill. App. 532;
Treat v. *Hiles*, 81 Wis. 280;
17 *Corpus Juris*, 757;
Ward v. *General Ice Cream Corp.*, 172 At. 781, 782; 118 Conn. 363, 366;
Re Schulte-United, Ltd. [1934], 4 Dominion Law R. 51;
Re: Metropolitan Chain Stores, 66 Fed. (2) 485, 487;
Eastman Co. v. *So. Photo Co.*, 273 U. S. 359, 378;
Story Parchment Co. v. *Paterson Co.*, 282 U. S. 555.

The principle is the same in tort and in contract.

5 *Williston on Contracts* (Rev. Ed.) § 1317;
Shannon v. *Shaffer Oil & Refining Co.*, 51 Fed. (2) 878, 881;
Martins Fork Coal Co. v. *Harlan-Wallins Coal Corp.*, 83 Fed. (2) 967, 969.

Even though the average net earnings were accurately ascertained to the last decimal place over any given period of time *previous* to rejection of the lease, the result is submitted for consideration in estimating damages accruing for a period *after* rejection. The past is the only index of the future, and in tort or contract is competent evidence.

United Electric Coal Co. v. *Rice,* 22 Fed. Supp. 221, 226;
5 *Williston on Contracts* (Rev. Ed.), § 1346A.

The variable, net earnings, is reduced to a constant annual average over various periods of past time by the application of various formulas, and the result in each calculation is shown in the X-2 series of Exhibits.

The Court of Appeals, for the reasons stated in its opinion (R. 299) chose Exhibit X-2D where the experience period on which the estimates of future net income were based was 14 years (R. 138). The figures for the net operating income were supplied by the New Haven and then repudiated. The first figures thus supplied totaled $5,359,325; the second figures totaled $5,458,787 (Ex. Y-1, R. 256). The total net income from the "controversial bus routes" for the period as reported by the New Haven came to $298,888.78 (Ex. Y-2, R. 258); which is added to $5,458,877, making a total net operating income for the 14 year period of $5,757,675.78. Dividing this total by the number of years in the period—14—gives a "normal year" operating income of $411,262.55 instead of $382,809 (Ex. X-2DD). Adding the new operating income average to the other two factors in statement annexed to Ex. X-2DD, gives $618,004.61 as the rental value, instead of $589,551. Thus, the error arising from the use of erroneous figures in the first instance is 4.6%: that is, the rental value is but 95.4% of what it "ought to be." The correction has been made by Judge Patterson in arriving at his result.